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13 UNITED STATES DISTRICT COURT
14 NORTHERN DISTRICT OF CALIFORNIA
15 OAKLAND DIVISION

16
17 In re ACCURAY INC. SECURITIES) Master File No. 09-cv-03362-CW
LITIGATION,)
18 _____)
19 This Document Relates To:)
20 ALL ACTIONS.)
21)
22)
23)
24 _____)
25)
26)
27)
28)
DEFENDANTS' NOTICE OF
MOTION AND MOTION TO
DISMISS; MEMORANDUM OF
POINTS AND AUTHORITIES IN
SUPPORT THEREOF
Date: None per Oct. 26, 2009 Order
Before: Hon. Claudia Wilken

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NOTICE OF MOTION AND MOTION

2 Defendants Accuray, Inc. (“Accuray” or the “Company”), Euan S. Thomson, Robert E.
3 McNamara, Wade B. Hampton, Ted Tu, Wayne Wu, John R. Adler, Jr. and Robert S. Weiss
4 (collectively, “Defendants”) move pursuant to the Private Securities Litigation Reform Act of
5 1995 (“Reform Act” or “PSLRA”), and Federal Rules of Civil Procedure 12(b)(6), 8 and 9(b),
6 for an order dismissing the [Corrected] Consolidated Class Action Complaint (“Complaint” or
7 “¶_”). The Court’s October 26, 2009 Order stated that the motion would be taken under
8 submission on the papers. Defendants respectfully believe oral argument would be appropriate.

9 Defendants move to dismiss the Complaint on the grounds that plaintiffs have failed to
10 satisfy the stringent pleading requirements of the Reform Act. This motion is based upon this
11 Notice and Motion; the Memorandum of Points and Authorities; the Request for Judicial Notice;
12 the Declaration of Diane Walters and attached exhibits; the pleadings, records, and papers filed
13 in this action; oral argument of counsel; and any other matters properly before the Court.

STATEMENT OF ISSUES (Civil L.R. 7-4(a)(3))

15 1. Have plaintiffs alleged with sufficient particularity the existence of an actionable
16 misrepresentation or omission?

17 2. Have plaintiffs alleged with sufficient particularity facts giving rise to a strong
18 inference that each of the Defendants acted with scienter?

19 3. Have plaintiffs stated a Section 10(b) claim against certain Defendants for
20 statements they did not make?

21 4. Have plaintiffs pleaded a cause of action for control person liability?

MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

Imagine that you have been diagnosed with brain cancer. You have two treatment options. Option One: the surgeon cuts your skull open and excises the tumorous portions of the brain. After recovering from surgery, you undergo prolonged treatment with chemotherapy and/or radiation. Option Two: the CyberKnife® System (“CyberKnife”), a non-invasive radiosurgery system. You go into a local hospital or out-patient center. A computer-controlled

1 robot delivers beams of pain-free radiation to the tumor site with pinpoint accuracy. No cutting
 2 or anesthesia. No nausea or hair loss. Little or no recovery time. Which would you prefer?

3 Founded in 1990, Accuray develops and sells the CyberKnife, which provides patients
 4 with an alternative to traditional surgery for the treatment of tumors. In 1999, Accuray received
 5 FDA clearance for the treatment of tumors in the head and neck, and in August 2001, it received
 6 clearance to treat tumors anywhere in the body where radiation treatment is indicated. Accuray's
 7 growth accelerated dramatically in the ensuing years. In the two years prior to its February 2007
 8 initial public offering ("IPO"), Accuray's revenues increased 136%, from \$22.4 million in fiscal
 9 2005 to \$52.9 million in fiscal 2006. Revenues continued to increase following the IPO, with
 10 fiscal 2007 revenues increasing to \$140.5 million (a 166% increase over fiscal 2006) and fiscal
 11 2008 revenues increasing to \$210.4 million (a 50% increase over fiscal 2007).

12 Although revenues were growing, Accuray encountered difficulties as a newly public
 13 company in a difficult economic and regulatory environment. As with any new medical device
 14 or treatment, CyberKnife sales are affected by many factors outside the Company's control,
 15 including, among others, FDA rules and regulations, a labyrinth of federal, state and third party
 16 payor requirements regarding insurance coverage and reimbursement, and market acceptance. In
 17 addition, given the several million dollar cost of each CyberKnife, the ability of customers to
 18 obtain financing is critical. Accuray provided detailed and extensive warnings regarding these
 19 risks in the IPO Registration Statement, subsequent SEC filings and other public statements.

20 Unfortunately, certain of the identified risks became realities. The uncertain economic
 21 environment, and in particular, tightening credit markets, began to impact customers' ability to
 22 obtain financing. In addition, uncertainty regarding proposed regulatory changes led to a
 23 slowdown in Accuray's free-standing center market segment.

24 The Complaint seeks to transform the difficulties that Accuray encountered into
 25 securities fraud. The gravamen of the Complaint is that during the Class Period, February 7,
 26 2007 through August 19, 2008, Accuray and seven of its current and former officers and
 27 directors deliberately misrepresented the Company's financial condition, and in particular, its
 28 backlog, as part of a scheme to artificially inflate the price of Accuray's stock to allow certain of

1 the individual defendants to sell stock at inflated prices.

2 Plaintiffs' allegations suffer from numerous fatal defects. *First*, plaintiffs fail to plead
 3 sufficiently the existence of a material misrepresentation or omission – an essential element of a
 4 Section 10(b) claim. The Reform Act requires plaintiffs to plead, with particularity, each
 5 statement alleged to have been misleading, the reasons why the statement was misleading, and
 6 all facts on which the allegations are based. Although plaintiffs cite a plethora of public
 7 statements, they fail to plead the requisite particularized facts necessary to establish falsity.

8 *Second*, many of the challenged statements were forward-looking in nature and
 9 accompanied by meaningful risk disclosures. Such statements are immunized from liability
 10 under the Safe Harbor for forward-looking statements. As the Complaint and its exhibits reveal,
 11 Accuray repeatedly cautioned investors about the potential negative impact of financing
 12 difficulties and proposed regulatory changes and promptly disclosed negative information.

13 *Third*, plaintiffs fail to plead particularized facts giving rise to a strong inference of
 14 scienter as to any of the Defendants. Indeed, plaintiffs do not plead any facts indicating what
 15 each individual defendant allegedly knew and when. Unable to plead facts to establish scienter
 16 directly, plaintiffs instead rely on “motive and opportunity” stock sale and executive
 17 compensation allegations. Plaintiffs’ motive allegations, however, are equally deficient and fail
 18 to provide the requisite strong inference of fraudulent intent.

19 In sum, plaintiffs’ allegations fail to withstand the formidable pleading requirements of
 20 the Reform Act, and the Complaint should therefore be dismissed.

21 **STATEMENT OF FACTS AND PROCEDURAL BACKGROUND**

22 Founded in 1990, Accuray designs, develops, and sells the CyberKnife, an image-guided
 23 robotic radiosurgery system designed to treat solid tumors. ¶ 2; *see* Ex. 1 to Plaintiffs’ Appendix
 24 of Exhibits to the Complaint (“Pl. Ex. __”), at 1. The CyberKnife received clearance from the
 25 Food and Drug Administration (“FDA”) for the treatment of tumors in the head and neck in July
 26 1999, and in August 2001, it received clearance to treat tumors anywhere in the body where
 27 radiation treatment is indicated. Pl. Ex. 1 at 1. Key benefits of the CyberKnife include: (1) it
 28 can be used to treat tumors that cannot be treated through surgery due to their location, number,

1 size, shape or proximity to vital organs, or because of the age or health of the patient; (2) the
 2 procedure can be performed on an outpatient basis and does not involve any cutting or
 3 anesthesia; and (3) the procedure requires little or no recovery time. *Id.* at 3.

4 Each CyberKnife costs several million dollars. ¶ 2. The sales and installation cycle is
 5 lengthy and often requires well over one year from negotiations to installation. Pl. Ex. 1 at 42.
 6 In the years preceding its IPO, Accuray grew rapidly, with revenues increasing to \$52.9 million
 7 in fiscal 2006 (“FY06”) from \$22.4 million in FY05, an increase of 136%. Pl. Ex. 1 at F-4.

8 On February 7, 2007, Accuray conducted its IPO. ¶ 50. In its Registration Statement,
 9 Accuray provided extensive disclosures detailing the risks related to its business. Among other
 10 risk factors, Accuray disclosed the following:

11 Because of the high unit price of the CyberKnife system, and the relatively small
 12 number of units installed each quarter, each installation of a CyberKnife system can
 13 represent a significant component of our revenue for a particular quarter. Therefore,
 14 if we do not install a CyberKnife system when anticipated, our operating results
 15 may vary significantly and our stock price may be materially harmed.

16 * * *
 17 Events beyond our control may delay installation and the satisfaction of
 18 contingencies required to receive cash inflows and recognize revenue, such as: . . .
19 customer funding or financing delay. . . . Therefore, delays in the installation of
 20 CyberKnife systems or customer cancellations would adversely affect our cash
 21 flows and revenue, which would harm our results of operations and could cause our
 22 stock price to decline.

23 * * *

24 *25 If third-party payors do not continue to provide sufficient coverage and
 26 reimbursement to healthcare providers for use of the CyberKnife system, our
 27 revenue would be adversely affected.*

28 Pl. Ex. 1 at 12-13 (emphasis added); *see id.* at 11-30. Accuray also disclosed the amount of
 29 business it had in backlog, and explained that the figure included only “deferred revenue and
 30 future payments that our customers are contractually committed to make, but which we have not
 31 yet received.” ¶ 6; Pl. Ex. 1 at 44.¹ Accuray further cautioned that it “may be unable to convert

26 ¹ Backlog typically is not reported in corporate financial statements and is not subject to
 27 Generally Accepted Accounting Principles (“GAAP”). *See* Donald E. Kieso, et al.,
 28 INTERMEDIATE ACCOUNTING, at 4 (10th Ed. 2001), attached as Ex. H to the Declaration of Diane
 Walters (“Walters Decl., Ex. __”). Thus, companies have discretion in selecting a methodology to
 calculate backlog.

1 all of this backlog into recognized revenue due to factors outside our control.” Pl. Ex. 1 at 44.²

2 On May 1, 2007, in a press release concerning its 3Q07 results, Accuray disclosed that it
3 would begin including contracts containing contingencies in backlog. ¶¶ 11, 61.

4 On August 16, 2007, Accuray announced its FY07 financial results (¶ 77), reporting
5 revenues of \$140.5 million, a 166% increase over FY06. Pl. Ex. 11. During a call with analysts
6 the same day, Accuray provided revenue guidance for FY08 of \$250-270 million. ¶ 78.

7 On September 4, 2007, Accuray filed its SEC Form 10-K for FY07 (¶ 89; Pl. Ex. 17 at
8 30), which provided detailed risk disclosures and also specifically cautioned that:

9 in connection with the release of proposed Medicare reimbursement rates for
10 calendar 2008, CMS has also proposed significant amendments to the regulations
11 under the federal Ethics in Patient Referrals Act, which is more commonly known
12 as the Stark Law. These proposed regulations would, among other things, impose
13 additional limitations on the ability of physicians to refer patients to medical
14 facilities in which the physician has an ownership interest for treatment. Physician
15 owned entities have increasingly become involved in the acquisition of medical
16 technologies, including the CyberKnife. In many cases, these entities enter into
17 arrangements with hospitals that bill Medicare for the furnishing of medical
18 services, and the physician owners are among the physicians who refer patients to
19 the entity for services. The proposed regulations, if adopted, would limit these
20 arrangements and could require the restructuring of existing arrangements between
21 physician owned entities and hospitals and may also discourage physicians from
22 participating in the acquisition and ownership of medical technologies. As a result,
23 these proposed regulations, if enacted, could have an adverse impact on our product
24 sales and therefore on our business and results of operations.

25 On November 7, 2007, Accuray issued a press release announcing record quarterly
26 revenues of \$48.6 million for 1Q08, representing a 48% increase over 1Q07. Pl. Ex. 20.

27 On January 30, 2008, Accuray announced revenues of \$52 million for 2Q08, representing
28 a 98% increase over 2Q07 revenues. ¶ 105; Pl. Ex. 26. Accuray, however, cautioned that, due to
economic conditions, and specifically the tightening credit markets, it was adjusting its revenue
guidance for FY08 to \$210-230 million, which would represent revenue growth of 50-64% over
FY07. Pl. Ex. 26. During an analyst conference call that same day, Accuray disclosed that a
number of contracts were being removed from backlog and explained that the freestanding center

² Accuray continued to provide detailed risk disclosures in its quarterly and annual filings throughout the Class Period. *See, e.g.*, Pl. Exs. 3 at 29-46, 17 at 26-46, 25 at 30-47.

1 market segment had been negatively impacted by proposed regulatory changes and tightening
 2 credit markets. Pl. Ex. 27 at 4-5.

3 On April 29, 2008, Accuray announced revenues of \$58.8 million for 3Q08, representing
 4 a 57% increase over 3Q07. ¶ 113; Pl. Ex. 32. Accuray also disclosed that additional contracts
 5 were being removed from backlog due to, among other factors, the tightening economy and
 6 uncertain regulatory environment. Pl. Ex. 33.

7 On August 19, 2008, Accuray announced its 4Q08 and FY08 results. ¶ 119. Accuray
 8 reported FY08 revenues of \$210.4 million, a 50% increase over FY07. *Id.* Accuray also
 9 disclosed that additional contracts were being removed from backlog due to various factors,
 10 including proposed regulatory changes, the general economy and the credit environment. ¶ 120.

11 Nearly a full year later, on July 22, 2009, the first of three class action complaints was
 12 filed in this Court challenging Accuray’s statements regarding backlog. The Court consolidated
 13 the actions, and on December 17, 2009, plaintiffs filed the instant Complaint. The Complaint
 14 asserts causes of action for alleged violations of Sections 10(b) and 20(a) of the Securities
 15 Exchange Act of 1934 (the “Exchange Act”) and generally alleges that the Defendants made
 16 false and misleading statements regarding Accuray’s business and financial performance.

17 ARGUMENT

18 I. LEGAL STANDARDS

19 To state a Section 10(b) claim, a plaintiff must plead: ““(1) a material misrepresentation
 20 or omission of fact, (2) scienter, (3) a connection with the purchase or sale of a security,
 21 (4) transaction and loss causation, and (5) economic loss.”” *Zucco Partners, LLC v. Digimarc*
 22 *Corp.*, 552 F.3d 981, 990 (9th Cir. 2009) (citation omitted). The Reform Act imposes rigorous
 23 pleading requirements for plaintiffs alleging securities fraud and provides that complaints that do
 24 not satisfy these requirements “shall” be dismissed. 15 U.S.C. § 78u-4(b)(1)-(3); *see Tellabs, Inc.*
 25 *v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007).

26 Among other requirements, plaintiffs must: “specify each statement alleged to have been
 27 misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding
 28 the statement or omission is made on information and belief … state with particularity all facts

1 on which that belief is formed.” 15 U.S.C. § 78u-4(b)(1)(B). Plaintiffs also must plead
 2 particularized facts “evidencing scienter, *i.e.*, the defendant’s intention ‘to deceive, manipulate,
 3 or defraud.’” *Tellabs*, 551 U.S. at 313 (citation omitted); 15 U.S.C. § 78u-4(b)(2) (plaintiffs
 4 must “state with particularity facts giving rise to a strong inference that the defendant acted with
 5 the required state of mind.”). In the Ninth Circuit, the requisite mental state for a Section 10(b)
 6 claim is “deliberately reckless or conscious misconduct.” *In re Silicon Graphics, Inc. Sec. Litig.*,
 7 183 F.3d 970, 974 (9th Cir. 1999) (“SGI”). With respect to claims based on “forward-looking”
 8 statements, actual knowledge of falsity is the required state of mind. 15 U.S.C. § 78u-5(c)(1)(B).

9 Where, as here, plaintiffs rely on statements from confidential witnesses (“CWs”) to
 10 plead their claims, they “must pass two hurdles to satisfy the PSLRA[:]” (1) “the confidential
 11 witnesses whose statements are introduced to establish scienter must be described with sufficient
 12 particularity to establish their reliability and personal knowledge;” and (2) “those statements
 13 which are reported by confidential witnesses with sufficient reliability and personal knowledge
 14 must themselves be indicative of scienter.” *Zucco*, 552 F.3d at 995.

15 **II. PLAINTIFFS FAIL TO PLEAD AN ACTIONABLE MISREPRESENTATION**

16 Plaintiffs allege four general categories of purportedly false or misleading statements:
 17 (1) “the definition, quality, and makeup of backlog;” (2) “the receipt of and accounting for
 18 customer deposits;” (3) “the Company’s revenue and earnings forecasts for FY08;” and
 19 (4) “revenue recognition processes on CyberKnife system sales to international customers.” ¶ 5.³

20 “*A litany of alleged false statements, unaccompanied by the pleading of specific facts
 21 indicating why those statements were false, does not meet [the PSLRA] standard.*” *Metzler Inv.
 22 GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1070 (9th Cir. 2008). Rather, “facts supporting
 23 falsity must be pled with particularity, including the ‘who, what, when, where, and how[.]’” *In re
 24 Downey Sec. Litig.*, 2009 WL 2767670, at *4 (C.D. Cal. Aug. 21, 2009) (citation omitted). As
 25 set forth below, because plaintiffs fail to plead with particularity material misrepresentations or
 26 omissions, the Complaint fails to state a claim under Section 10(b).

27
 28 ³ Forward-looking statements regarding (1) and (3) are discussed in Section III, *infra*.

1 **A. Plaintiffs Fail to Allege Falsity with respect to the Backlog Statements**

2 Most of the statements challenged in the Complaint pertain to the manner in which the
 3 Company defined and reported backlog during the Class Period. Plaintiffs' allegations – which
 4 rely heavily on CWs – fail to meet the stringent requirements of the Reform Act.

5 **1. Registration Statement Definition of Backlog.**

6 Plaintiffs claim that the “definition” of backlog used in the Registration Statement and
 7 subsequent SEC filings was false and misleading (¶¶ 5, 6, 53) because, although Accuray
 8 represented that “backlog consisted of CyberKnife sales and revenues with no contingencies, that
 9 customers were contractually committed to make” (¶ 7), Accuray had switched from Letters of
 10 Intent (“LOIs”) to “Term Agreements” which “contained language allowing for contingencies to
 11 be self-satisfying[.]” ¶ 68. Plaintiffs further allege that self-satisfying contingencies resulted in
 12 backlog being inflated because the “customers need not do anything for a contingency to be
 13 satisfied, resulting . . . [in] deals being reported as non-contingent or having a substantially high
 14 probability of being converted into revenue when this was not the case.” ¶ 68.⁴ Plaintiffs
 15 appear, however, to be mixing concepts, as the challenged statements do not make any reference
 16 to “LOIs” or “Term Agreements,” nor do Plaintiffs explain how “self-satisfying” contingencies
 17 made conversion to revenue less likely.

18 Instead, plaintiffs rely heavily on opinions purportedly offered by CW1, allegedly a
 19 regional sales director from 2004 to 2007. ¶¶ 43(a), 68(a). CW1’s personal opinion regarding
 20 the use of “Term Agreements,” however, has no bearing on the accuracy of the backlog
 21 definition. CW1 does not purport to have been involved in the development of the definition,
 22 nor does CW1 claim to have been involved in determining which deals would be included in
 23 backlog. Moreover, CW1 concededly had no communications with executives regarding the use
 24 of Term Agreements. ¶ 68(a) (“CW1 said that the Company executives did not explain to sales
 25 staff why this change was being made[.]”). CW1’s opinion that the language of the Term

26
 27 ⁴ Plaintiffs also contend that the inclusion of contracts with self-satisfying contingencies in
 28 backlog after May 1, 2007 rendered statements regarding backlog false and misleading. *See e.g.*
 ¶ 104. For the same reasons as articulated below, this claim also fails.

1 Agreements “seemed geared to allow far more speculative, contingent deals to be added to the
 2 order backlog” (*id.*) is nothing more than speculation. *See, e.g., Weiss v. Amkor Techn., Inc.*, 527
 3 F. Supp. 2d 938, 954 (D. Ariz. 2007) (finding CW allegation that “inflated forecasts occurred
 4 because senior management failed to implement a centralized and effective forecasting system”
 5 insufficient because it was “simply CW1’s purported opinion”).

6 In any event, plaintiffs’ allegations regarding “self-satisfying contingencies” make no
 7 sense. The use of agreements with self-satisfying contingencies – a practice that is far from
 8 unusual – does not render the statement that backlog included only non-contingent contracts
 9 false. If the contingencies in a contract were satisfied, whether by act or time, and the customer
 10 was thus legally obligated to purchase a CyberKnife, the contract would be “non-contingent.”

11 **2. Change in the Definition of Backlog.**

12 Plaintiffs further contend that Accuray’s statements on May 1, 2007 regarding the
 13 decision to now include contingent contracts in backlog (*e.g., ¶¶ 60-62*) were false and
 14 misleading because Accuray “falsely stated that the change in the definition of backlog was
 15 driven by the ***increased demand*** for the CyberKnife and new contracts with customers[.]” ¶ 62.⁵
 16 Nowhere in the Complaint, however, do plaintiffs provide particularized facts demonstrating that
 17 demand for the CyberKnife *was not increasing* in May 2007 or that the number of new contracts
 18 was not growing. Nor can plaintiffs plead falsity as to this and later statements reiterating the
 19 new definition based on Accuray’s subsequent reductions in backlog or the later decision to
 20 exclude contingent contracts from backlog. ¶ 128. As this Court recently explained, “[p]laintiffs
 21 cannot simply rely on a ‘fraud by hindsight’ theory to demonstrate falsity.” *In re Rackable Sys.,*
 22 *Inc. Sec. Litig.*, 2010 WL 199703, at *5 (N.D. Cal. Jan. 13, 2010) (citation omitted).

23 **3. “[Q]uality and makeup of backlog.”**

24 Plaintiffs also challenge a number of statements regarding what plaintiffs characterize as

25
 26 ⁵ To the extent that plaintiffs also allege that the statements regarding the definitional change
 27 were misleading because Accuray “falsely told investors that the new backlog figures were the
 28 best indicator of future revenue results” (¶¶ 60, 62), such statements are clearly forward-looking
 and thus actionable under the Reform Act’s Safe Harbor. *See infra* at Section III.

1 the “quality and makeup” of backlog and allege that they were false and misleading because
 2 backlog included contracts for which Accuray had not received a deposit and contracts that had
 3 been “cancelled” or were “suspect.” *E.g.*, ¶¶ 5, 6, 13-14, 60, 74, 80, 87. With respect to the
 4 deposit claim, as explained *infra* at 12, the allegations are based on a mischaracterization of
 5 Accuray’s statements and also fail to show that depositless deals were inherently “suspect.”

6 Likewise, plaintiffs’ allegations regarding “cancelled” contracts lack the requisite
 7 specificity. Plaintiffs again rely on CW1, who allegedly reported that:

8 the time between Accuray receiving notice that a customer wanted to cancel and
 9 the time that Accuray would actually remove the items from backlog depended on
 10 how much the Company needed the deal in backlog. The Company would receive
 letters from customers requesting that Accuray de-book a deal and the Company
 would not remove the deal from backlog, sometimes for months.

11 ¶ 74. These allegations fail to support plaintiffs’ claims for several reasons. As explained *supra*
 12 at 8-9, plaintiffs do not allege that CW1, a *regional* sales director, had any involvement in
 13 corporate level backlog decisions. The allegation is also vague as to time and as to the purported
 14 impact on backlog; it is unclear how the alleged cancellations impacted the figures or definitions
 15 reported by the Company. *Cf. Alaska Elec. Pension Fund v. Adecco S.A.*, 434 F. Supp. 2d 815,
 16 828 (S.D. Cal. 2006), *aff’d*, 256 Fed. Appx. 74 (9th Cir. 2007) (noting failure of CWs to
 17 “provide any allegations quantifying the impact of the[] alleged improprieties on [the
 18 company’s] revenues, or . . . year-end financial results”). More importantly, CW1 left the
 19 Company in 2007 (¶ 43(a)) and thus was not even employed at Accuray for much, if not most, of
 20 the Class Period. *See Brodsky v. Yahoo! Inc.*, 592 F. Supp. 2d 1192, 1200-01 (N.D. Cal. 2008)
 21 (“*Yahoo! I*”) (where class period extended until 2006 but CW stopped working at company in
 22 2004, the “temporal gap belies the credibility of Plaintiffs’ allegation”).

23 CW5’s allegations also add little to the analysis. CW5, allegedly a Director of Marketing
 24 and Placement, reported that cancelled orders were not “de-book[ed]” if the cancellation was
 25 shortly before the end of the quarter and reported seeing cancelled orders in a “list of pending
 26 installations.” ¶ 74(b). Plaintiffs, however, fail to specify how CW5, as a marketing employee,
 27 would have had access to corporate backlog reports or how a “list of pending installations” and
 28 “de-book[ings]” bore on the figures reported by Accuray. *See supra* at 10. CW2’s information

1 is even weaker as it concededly is based on purportedly “*hear[ing]* that the Company would
 2 delay taking a sale off the books even after a customer would ask to have it cancelled, resulting
 3 in inflated backlog figures.” ¶ 74(c) (emphasis added); *Downey*, 2009 WL 2767670, at *9
 4 (“[T]he statements of a confidential witness are disregarded if lacking in specificity or based on
 5 hearsay, rumor, or speculation.”). Thus, the allegations regarding cancelled contracts are
 6 insufficient to plead falsity.

7 Plaintiffs further contend that backlog was inflated because it included “suspect”
 8 contracts that did not have a high probability of being converted into revenue. ¶ 73. Once again,
 9 however, the CW allegations lack specificity and are based on speculation and rumor as opposed
 10 to personal knowledge. *E.g.*, ¶ 73(f) (“CW5 . . . stated that Nash was the salesperson known for
 11 having the highest percentage of cancelled contracts[.]”); ¶ 73(d) (reporting hearsay of Snarsky);
 12 ¶ 73(l) (“CW9 *was told* by employees”) (emphasis added); *see supra* at 10-11.⁶

13 Likewise, the personal *opinions* of CWs as to whether and which contingent contracts
 14 should have been included in backlog cannot substitute for particularized facts. For example,
 15 CW11 opines that “no contingent orders of any kind should have been included in the backlog.”
 16 ¶ 73(m). CW11’s personal opinion, however, fails to demonstrate that the reported numbers
 17 were false when made. *See supra* at 8-9.

18 **4. Reasons for the Reductions in Backlog.**

19 Plaintiffs allege that the “reason for the withdrawal of millions from backlog” was not
 20 “associated with the tightening credit markets,” as Defendants indicated, but rather was because
 21 “backlog was full of deals with no real likelihood of ever resulting in a system install[.]” ¶¶ 105-
 22 06. As explained *supra* at 9-11, however, plaintiffs fail to plead particularized facts supporting
 23 this contention. Moreover, plaintiffs fail to allege facts showing that the tightening credit market
 24 did *not* affect Accuray’s business. Indeed, such a contention defies credulity, given the sweeping
 25 impact that the credit crisis has had on companies worldwide.

26
 27 ⁶ The Complaint also fails to specify how CW1 and CW11’s statements regarding the issues
 28 with the Oncuris deal affected reported backlog. ¶ 73(h)-(i).

1 **B. Plaintiffs' Falsity Allegations Regarding Deposits Are Insufficient**2 **1. Receipt of Deposits.**

3 Plaintiffs allege that the Registration Statement falsely stated that:

4 *[Accuray] typically receive[s] a deposit at the time the CyberKnife system purchase*
5 *contract is executed, and the remaining balance for the purchase of the CyberKnife*
5 *system upon installation[.]*6 ¶ 8; *see id.* ¶ 70. Plaintiffs allege that this was false because Accuray did not always receive a
7 deposit. ¶ 70. Merely alleging that Accuray did not receive deposits for all deals, however, does
8 not demonstrate the falsity of the challenged statement. To the contrary, as plaintiffs' allegations
9 make clear, Accuray simply stated that a deposit "typically" was received; it did not state that a
10 deposit was received in every instance. *See* ¶ 8.11 **2. Recognition of Deposits as Revenue.**

12 Plaintiffs further contend that the Registration Statement falsely stated that:

13 *[i]n the event that a customer does not, for any of the reasons above or other*
14 *reasons, proceed with installation of the system after entering into a purchase*
14 *contract, we would only recognize the deposit portion of the purchase price as*
14 *revenue. . . .*16 ¶ 8; *see id.* ¶ 70. Plaintiffs allege that this was false because "deposits were almost always
17 refunded back to the customers in the event that customers cancelled the contracts." ¶ 70. This
18 statement, however, *says nothing* about whether Accuray had a policy of always keeping
19 deposits upon cancellation. To the contrary, the statement simply clarifies that where a deposit
20 was kept after cancellation, Accuray would recognize it as revenue. ¶ 8.21 Regardless, the allegations are once again based on information provided by CWs (CW1,
22 CW10, CW11), none of whom is alleged to have been in a finance or accounting position. ¶ 70.
23 Thus, none of the CWs can speak to revenue recognition practices. *See, e.g., Brodsky v. Yahoo!*
24 *Inc.*, 630 F. Supp. 2d 1104, 1115 (N.D. Cal. 2009) ("Yahoo! II") ("Plaintiffs must describe with
25 particularity the CW's personal knowledge of [the Company's] revenue recognition process.").26 **C. Plaintiffs' Falsity Allegations with respect to International Sales Also Fail**27 Plaintiffs also challenge statements in the Registration Statement pertaining to
28 recognition of revenue for international sales. Plaintiffs allege that the statement that Accuray

1 “typically recognized revenue when the system is *delivered* to the end user’s site” (¶ 55) was
 2 false and misleading because Accuray actually recognized revenue upon shipment to the
 3 distributor (as opposed to the end-user). ¶ 95. In support of this contention, plaintiffs point only
 4 to a statement made by Robert McNamara during a conference call on November 7, 2007, which
 5 plaintiffs claim “revealed” the truth regarding international sales revenue recognition:

6 [i]t kind of depends – it depends whether our distributor has the capability of
 7 installing, or as part of the contract, we are meant to install it. If we are meant to
 8 install it then we have to install it before we recognize revenue. If the distributor
 9 has the capability to install or we’ve fulfilled sort of our obligation, if you will, then
 we would recognize revenue. So in some cases, we would recognize it upon
 shipment, but it really depends on that particular distributor and their capabilities.
 Typically, it is a ship through to the customer though.

10 Pl. Ex. 21 at 14. This is hardly a “revelation” and certainly does not negate Accuray’s prior
 11 statements. Mr. McNamara simply stated the obvious: revenue recognition depended on the
 12 *terms of the contract*. If the contract required Accuray to install the product, revenue could only
 13 be recognized upon installation. If Accuray’s contractual obligation was limited to shipping the
 14 system to the distributor, revenue could be recognized upon shipment. The statement that
 15 revenue was “typically” recognized upon delivery to the end user does not preclude recognition
 16 upon shipment to the distributor where the contract specified that Accuray’s obligations
 17 terminated upon shipment. Because the statement by Mr. McNamara is not inconsistent with the
 18 prior representation by Accuray, plaintiffs have failed to demonstrate falsity. *Ronconi v. Larkin*,
 19 253 F.3d 423, 434 (9th Cir. 2001) (“The circumstances are not inconsistent with the statements
 20 so as to show that the statements must have been false or misleading when made.”).

21 In any event, plaintiffs fail to allege even the basic details of accounting fraud, including,
 22 among others, the amounts by which the financials purportedly were overstated, the dates of the
 23 transactions, or the identity of the individuals involved. *See, e.g., In re Seracare Life Scis., Inc.*,
 24 2007 WL 935583, at *8 (S.D. Cal. Mar. 19, 2007) (finding CWS’ allegations that “[the company]
 25 habitually shipped products out before customers wanted the product at the end of quarters so
 26 that they could recognize revenue during that quarter” insufficient “because they fail to allege the
 27 specific products that were involved . . . when they were shipped, how much revenue was
 28 recorded on [the] financial statements . . . and how [it] violated GAAP”). Nor do plaintiffs

1 allege – as they must – the cited CWS’ ¶ 99) “roles in [the] revenue recognition process and that
 2 they had personal knowledge of Defendants’ accounting decisions.” *Yahoo! II*, 630 F. Supp. 2d
 3 at 1114. Plaintiffs’ revenue recognition allegations thus fail to withstand scrutiny.

4 **III. THE FORWARD-LOOKING STATEMENTS ARE NOT ACTIONABLE**

5 The Complaint challenges three categories of forward-looking statements: (a) FY08
 6 revenue projections;⁷ (b) statements concerning the likelihood that backlog would be converted
 7 to revenue; and (c) publicly announced backlog figures. The “Safe Harbor” immunizes forward-
 8 looking statements if they are either (i) identified as forward-looking and accompanied by
 9 meaningful cautionary language “*or*” (ii) made without actual knowledge of falsity. 15 U.S.C.
 10 § 78u-5(c)(1) (emphasis added).⁸ The provision is in the disjunctive; thus, protection is not lost
 11 merely because a complaint alleges the defendants knew their statements were false: “[t]he first
 12 prong of the safe harbor requires courts to examine only the cautionary statement accompanying
 13 the forward-looking statement. Courts should not examine the state of mind of the person
 14 making the statement.” H.R. Conf. Rep. No. 104-369, at 44, 1995 U.S.C.C.A.N. 730 (1995).⁹

15 Where, as here, the challenged forward-looking statements were accompanied by
 16 meaningful cautionary statements, they cannot give rise to liability under the first prong of the
 17 Safe Harbor. The forward-looking statements are also separately immunized under the second
 18 prong, as plaintiffs fail to plead facts showing actual knowledge. *See infra* at 17-19, 24.

19 **A. Many of the Challenged Statements Were Forward-Looking**

20 Forward-looking statements include: (A) “a projection of revenues . . . or other financial

22 ⁷ Although plaintiffs also allege that Defendants provided false and misleading earnings
 23 guidance, a review of the cited documents reveals that Defendants did not give any earnings
 24 guidance, thus the non-existent earnings guidance could not have been false or misleading. *See, e.g.*, Pl. Ex. 12 at 6 (“We are not giving earnings guidance for FY ’08 at this time[.]”).

25 ⁸ The Safe Harbor effectively codified the judicially created “bespeaks caution” doctrine,
 26 which also protects forward-looking statements accompanied by cautionary language. *See Employers Teamsters Local Nos. 175 and 505 Pension Plan Trust Fund v. Clorox Co.*, 353 F.3d 1125, 1132 (9th Cir. 2004). Defendants also seek dismissal pursuant to this doctrine.

27 ⁹ *See In re Portal Software, Inc. Sec. Litig.*, 2006 WL 2385250, at *12 (N.D. Cal. Aug. 17, 2006) (“[I]f a statement is accompanied by meaningful cautionary language, the defendants’ state of mind is irrelevant.”) (citation omitted).

1 items;” (B) “the plans and objectives of management for future operations;” (C) “a statement of
 2 future economic performance;” and (D) “any statement of the assumptions underlying or relating
 3 to any statement described in subparagraph (A), (B), or (C).” 15 U.S.C. § 78u-5(h)(i)(1).

4 The challenged FY08 revenue forecast¹⁰ clearly is “a projection of revenues.” 15 U.S.C.
 5 § 78u-5(h)(i)(1)(A).¹¹ Likewise, Accuray’s statements that it believed there was a “substantially
 6 high probability” of converting the contingent contracts in backlog into future revenue,¹² as well
 7 as statements that it was “confident” or “believed” that 90% of the total backlog would
 8 ultimately be converted to revenue,¹³ were forward-looking since they contained predictions
 9 about the future. 15 U.S.C. § 78u-5(c)(1)(A).¹⁴ Accuray’s statements concerning its backlog
 10 figures¹⁵ were forward-looking for similar reasons. Indeed, plaintiffs’ own Complaint claims
 11 that the backlog figures were interpreted by investors as predictions of the future. *See, e.g.*, ¶ 30
 12 (“The Company’s reported backlog was . . . the metric that the Company used to measure . . .
 13 future financial performance.”).¹⁶

14
 15 ¹⁰ ¶ 88; *see also id.* ¶¶ 16, 20, 78, 85, 93, 97, 106.

16 ¹¹ Accuray also identified these statements as forward-looking in its public statements. *See, e.g.*, Pl. Ex. 12 at 2 (“I need to remind you that, except for historical information, the matters presented in this conference call, including statements as to financial guidance . . . are forward-looking statements and within the meaning of the Safe Harbor[.]”); Pl. Ex. 20.

17 ¹² *E.g.*, ¶¶ 6-7, 11, 16, 26, 61, 62, 66, 68, 77-78, 87, 93, 103, 105, 119, 120.

18 ¹³ *E.g.*, ¶¶ 14, 16, 31, 62, 68, 76, 78.

19 ¹⁴ The statements were also specifically identified as forward-looking in press releases, SEC filings and conference calls. *See, e.g.*, note 11, *supra*.

20 ¹⁵ *E.g.*, ¶¶ 11, 13, 26, 60-61, 64, 77-79, 84, 87, 93-94, 96-97, 100, 105, 115.

21 ¹⁶ *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982 (9th Cir. 2008), is not to the contrary. Plaintiffs in *Berson* alleged that Applied Signal’s statements regarding its backlog were rendered misleading by the failure to disclose that it had received “stop-work orders” on orders it included in backlog. *Id.* at 984. The defendants argued that the statements about backlog were forward-looking. *Id.* at 990. The company, however, had explicitly stated that its backlog was “subject **only to** the cancellation and modification provisions contained in our contracts.” *Id.* at 985-86 (emphasis added). In holding that the statements were not forward-looking, *Berson* found that, “as Applied Signal uses the term, ‘backlog’ isn’t a ‘projection’ of earnings or a ‘statement’ about ‘future economic performance,’” but was instead analogous to accounts receivable in that it “represents Applied Signal’s *contractual entitlement to perform certain work[.]*” *Id.* at 990 (emphasis added; citation omitted). Unlike Applied Signal, Accuray disclosed the inclusion of “contingent” contracts in its backlog, based on its estimation of whether or not those contracts *would be converted to revenue in the future*. Thus, as Accuray used the term, backlog was a

(continued...)

1 A statement's use of the present, past, or future tense does not determine whether it is
 2 forward-looking; rather, the salient inquiry is whether truth or falsity can be discerned until some
 3 point after the statement is made. *See, e.g., Harris v. IVAX*, 182 F.3d 799, 805 (11th Cir. 1999);
 4 *In re Splash Tech. Holdings, Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1067-68 (N.D. Cal. 2001).
 5 Here, Accuray's actual realization of revenue from backlog could not be determined until long
 6 after those statements were made.¹⁷

7 **B. The Company Provided Meaningful Cautionary Language**

8 To qualify for the Safe Harbor, a defendant must also identify "important factors that
 9 could cause actual results to differ materially from those in the forward-looking statements." 15
 10 U.S.C. § 78u-5(c)(1)(A)(i). A company need not list all important factors or even the particular
 11 factor that caused the forward-looking statement to be an inaccurate prediction. *See, e.g.,*
 12 *Clorox*, 353 F.3d at 1133; *IVAX*, 182 F.3d at 807.

13 Accuray repeatedly warned that its results could differ from its forward-looking
 14 statements.¹⁸ Lengthy risk disclosures in SEC filings identified specific risks that directly related
 15 to the forward-looking statements. *See, e.g.*, Pl. Ex. 17 at 26-44; Pl. Ex. 25 at 30-45. Indeed,
 16 although these disclosures need not have warned of the precise risks that came to pass for the
 17

18 (...continued from previous page)
 19 projection. *See* Pl. Ex. 17 at 58 (defining contingent contracts as those that have a "substantially
 20 high probability" of being converted into revenue). Indeed, Accuray further disclosed to its
 21 investors that on a quarterly basis, it would review "whether customer engagement and progress
 22 toward satisfaction of contingencies *warrants continued inclusion* of the contract within
 23 backlog." *Id.* (emphasis added). Where plaintiffs in *Berson* contended that the backlog figure
 24 was a present figure that was falsely represented, here plaintiffs argue that Defendants'
 25 *projection of future revenue* to be achieved from backlog was false.

26 ¹⁷ Even if the figures were viewed as "mixed" statements consisting of both historical and
 27 forward-looking information, the Safe Harbor would apply. *See, e.g., IVAX*, 182 F.3d at 806
 28 ("[W]hile the statute does not tell us exactly what to do with a mixed statement, extrinsic sources
 29 of congressional intent point strongly toward treating the entire list as forward-looking.").

30 ¹⁸ *See, e.g.*, Pl. Ex. 11 at 4 (identifying specific factors and referring investors to the detailed
 31 risk disclosures in the Form 10-Q); Pl. Ex. 12 at 2-3; Pl. Ex. 20. Risk disclosures can be
 32 incorporated by reference. *See, e.g., In re ESS Tech., Inc. Sec. Litig.*, 2004 WL 3030058, at *9
 33 (N.D. Cal. Dec. 1, 2004) (applying safe harbor where press releases directed readers to SEC
 34 filings containing cautionary language); *Clorox*, 353 F.3d at 1133 (oral forward-looking
 35 statements do "not require that the cautions physically accompany oral statements") (citing 15
 36 U.S.C. § 78u-5(c)(2)(B)(i)).

1 Safe Harbor to apply, they did so here. For instance, Accuray warned that it “may be unable to
 2 convert all of this backlog into recognized revenue due to factors outside our control[.]” Pl. Ex.
 3 17 at 59; Pl. Ex. 25 at 23. Accuray explained that “customer funding [and] financing delay”
 4 were among “[e]vents beyond our control [that] may delay installation and the satisfaction of
 5 contingencies required to receive cash inflows and recognize revenue[.]” Pl. Ex. 17 at 28; Pl.
 6 Ex. 25 at 32. Accuray also disclosed that “[c]ontingencies associated with contingent contracts
 7 that are included within backlog may include . . . establishment of financing and legal entities by
 8 purchasers of systems.” Pl. Ex. 17 at 58. Accuray further cautioned that its results could “vary
 9 significantly” if it was unable to “install a CyberKnife system when anticipated” due to “a
 10 change in a customer’s financial condition or ability to obtain financing.” Pl. Ex. 17 at 27-28; Pl.
 11 Ex. 25 at 31-32. Thus, the forward-looking statements are protected by the Safe Harbor.

12 **IV. PLAINTIFFS FAIL TO PLEAD A STRONG INFERENCE OF SCIENTER**

13 As an initial matter, plaintiffs cannot show scienter where, as here, they fail to plead
 14 falsity, because “*a fortiori* they have not established that defendants knew those statements were
 15 false.” *Karacand v. Edwards*, 53 F. Supp. 2d 1236, 1252 (D. Utah 1999); *accord Phillips v. LCI*
 16 *Int’l, Inc.*, 190 F.3d 609, 621 (4th Cir. 1999). Even assuming that plaintiffs had sufficiently
 17 pleaded falsity, plaintiffs’ scienter allegations are deficient. The Reform Act requires plaintiffs
 18 to “state *with particularity* facts giving rise to a *strong inference* that the defendant acted with the
 19 required state of mind.” 15 U.S.C. § 78u-4(b)(2) (emphasis added). Courts “must consider *all*
 20 reasonable inferences to be drawn from the allegations, including inferences unfavorable to the
 21 plaintiffs.” *Metzler*, 540 F.3d at 1061 (citation omitted).

22 **A. Plaintiffs Provide No Direct Evidence of Scienter**

23 **1. The Complaint Does Not Plead Facts Demonstrating Each 24 Defendant’s Awareness of Contemporaneous Internal Information Contradicting the Challenged Public Statements.**

25 To plead scienter, “the complaint must contain allegations of *specific contemporaneous*
 26 *statements or conditions* that demonstrate the intentional or the deliberately reckless false or
 27 misleading nature of the statements when made.” *Ronconi*, 253 F.3d at 432 (emphasis added;
 28 citation omitted); *Metzler*, 540 F.3d at 1066 (same). Plaintiffs fail to plead facts identifying

1 contemporaneous material information known to any Defendant that contradicted public
 2 statements at the time they were made. Plaintiffs' failure to plead such details is fatal to their
 3 claim. *See, e.g., Alaska Elec. Pension Fund*, 434 F. Supp. 2d at 823 ("Plaintiffs must allege facts
 4 showing Defendants knew, when preparing the year-end financials ... that the receivables should
 5 have been written off, but they fraudulently chose to delay the write-down.").

6 **2. The Confidential Witnesses' Allegations Do Not Overcome Plaintiffs'
 7 Failure to Allege Contemporaneous Facts Known to the Defendants.**

8 As explained *supra* at 8-12, plaintiffs' CW allegations suffer from numerous deficiencies
 9 and are thus neither cogent nor compelling. Indeed, these allegations have no probative value at
 10 all with respect to six of the seven individual defendants (Messrs. McNamara, Thomson, Wu,
 11 Tu, Adler, and Weiss) because none of the CWs purports to have had any personal interaction
 12 with these individuals.¹⁹ Thus, no CW is in a position to speak to what any of these individuals
 13 did or did not know at the time each of the challenged statements was made. *See, e.g., Rackable*,
 14 2010 WL 199703, at *8 ("The two remaining CWs ... are not alleged 'to have had any
 15 interaction or communication with any of the defendants, or to have provided any defendant with
 16 information, or to have heard or read any statement by any defendant, that contradicted or even
 17 cast doubt on a public statement[.]'") (citation omitted); *McCasland v. FormFactor, Inc.*, 2009
 18 WL 2086168, at *5 (N.D. Cal. July 14, 2009) (CWs failed to provide "any specific information
 19 to defendants," including emails, internal memos or reports, that "contradict[ed] any public
 20 statement made," and failed to show "that any CW heard or read any specific private statement
 21 by a defendant that contradicted a public statement").

22 With respect to Mr. Hampton, three of the CWs allegedly reported that the sales staff told
 23

24 ¹⁹ Although CW4 claims that "all of the senior executives," including Dr. Thomson, attended
 25 sales presentations that "typically took place in the first quarter" where they allegedly would hear
 26 John Nash's "outrageous forecasts" (¶ 73(e)), the allegations once again are based on personal
 27 opinion, innuendo and gossip. *See supra* at 10-11. Moreover, CW4 does not claim to have had
 28 any communications with Dr. Thomson at these meetings or at any other time, much less
 discussed Mr. Nash with him. *See, e.g., In re Metawave Communications Corp. Sec. Litig.*, 298
 F. Supp. 2d 1056, 1073-74 (W.D. Wash. 2003) (holding that CW allegations were not
 sufficiently specific where they did not include where and when meetings took place, who
 attended or what was specifically discussed).

1 him that there was “no way” that they could sell 100 CyberKnives (¶¶ 17, 88). As explained
 2 *supra* at 8-12, however, the allegations attributed to CW2, CW3, and CW4 suffer from numerous
 3 weaknesses: (1) CW2 and CW4 allegedly were regionally based (¶ 43) and thus did not have
 4 personal knowledge of day-to-day activities at Accuray’s corporate headquarters; (2) none of
 5 these CWs purports to have been involved in determining corporate level backlog or preparing
 6 revenue forecasts; (3) two of the three CWs ceased working at Accuray in 2007 – long before the
 7 end of the Class Period in 2008; and (4) much of the information attributed to these CWs is
 8 based on hearsay, opinion and gossip. Moreover, and fatal to the claim against Mr. Hampton,
 9 this alleged sales target was purely internal. Although plaintiffs allege that “multiple CWs report
 10 that the [\$250-270 million revenue forecast] was based on” Mr. Hampton’s sales targets (¶ 88),
 11 not one of the CWs claims to have been involved in preparing the revenue forecast and thus
 12 cannot claim to have personal knowledge about such forecasts.²⁰ *See Zucco*, 552 F.3d at 996
 13 (where CWs “were simply not positioned to know the information alleged,” such allegations are
 14 insufficient to raise a strong inference of scienter).

15 **B. Plaintiffs’ Motive Allegations Are Insufficient to Raise a Strong Inference of
 16 Scienter**

17 **1. The Stock Sale Allegations Fail to Provide the Missing Inference of
 18 Scienter.**

19 Plaintiffs rely heavily on allegations of insider trading in an attempt to establish a motive
 20 to commit securities fraud. Mere allegations of stock sales, however, do not give rise to a strong
 21 inference of scienter. To the contrary, the Ninth Circuit has held that “insider trading is
 22 suspicious only when it is dramatically out of line with prior trading practices at times calculated
 23 to maximize the personal benefit from undisclosed inside information.” *SGI*, 183 F.3d at 986

24 ²⁰ Although CW11 allegedly participated in backlog meetings attended by representatives
 25 from the Finance, Legal and Sales departments, including Mr. Hampton, and separately claims
 26 that the “J.L. Parrott deals were definitely included in the Watch List during the backlog
 27 meetings” (¶ 73(m)), CW11 does not claim to have discussed these deals with Mr. Hampton (or
 28 any other defendant) at any time. *See, e.g., In re Medicis Pharma. Corp. Sec. Litig.*, 2009 WL
 4755406, at *12 (D. Ariz. Dec. 2, 2009) (finding CW allegations regarding alleged interaction
 with CFO failed “to support a conclusion that [the CW] had personal knowledge about the
 Defendants’ improper state of mind” where the complaint failed to “specify when alleged
 conversations . . . took place” or to “provide details about the content of those conversations”).

1 (citation omitted). To analyze these allegations, courts must examine: “(1) the amount and
 2 percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were
 3 consistent with the insider’s prior trading history.” *Id.* An analysis of these factors reveals that
 4 the stock sale allegations fall far short of providing the requisite strong inference of scienter.

5 **Amount and Percentage Sold.** Plaintiffs do not allege that Messrs. McNamara, Weiss,
 6 or Hampton sold any stock during the Class Period. The absence of sales by these individuals
 7 contradicts plaintiffs’ claim that they were committing securities fraud because they sought to
 8 profit from insider stock sales. *Ronconi*, 253 F.3d at 436 (“One insider’s . . . sales do not support
 9 the ‘strong inference’ required by the statute where the rest of the equally knowledgeable
 10 insiders act in a way inconsistent with the inference that the favorable characterizations of the
 11 company’s affairs were known to be false when made.”) (footnotes omitted); *see Metzler*, 540
 12 F.3d at 1067 (same). Further refuting an inference of scienter is the fact that two of these
 13 individuals *purchased* Accuray shares during the Class Period. Mr. Weiss purchased **100,000**
 14 **shares** (Ex. F) and Mr. Hampton purchased 9,000 shares (Ex. C). *See, e.g., See Iron Workers*
 15 *Local 16 Pension Fund v. Hilb Rogal & Hobbs Co.*, 432 F. Supp. 2d 571, 594 (E.D. Va. 2006)
 16 (“The fact that a defendant acquires stock . . . further negates any idea that Defendants had a
 17 motive to commit fraud.”) (citations omitted).

18 With respect to the individual defendants who did sell stock,²¹ the percentages were not
 19 unusual or suspicious: Dr. Thomson sold 10.5%, and outside directors Wayne Wu and Dr. John
 20 Adler sold 8.2% and 17.2%, respectively.²² *See, e.g., Metzler*, 540 F.3d at 1067 (finding CEO’s
 21 stock sales of “only 37%” of total holdings insufficient to support scienter). Moreover, plaintiffs
 22 omit several important facts that further weaken any inference of scienter. For example,
 23

24 ²¹ The alleged stock sales by Messrs. Lindquist and Raanes, who are not defendants, are
 25 irrelevant. “Plaintiffs have not alleged how these sales [by non-defendants] impute scienter to
 26 Defendants.” *Rackable*, 2010 WL 199703, at *9; *see Tripp v. IndyMac Fin. Inc.*, 2007 WL
 27 4591930, at *4 n.1 (C.D. Cal. Nov. 29, 2007) (“Any sales by a non-defendant are irrelevant.”).

28 ²² *See* Walters Decl, Exs. A, B, D, G. Exercisable options are included in total
 29 stockholdings. *See, e.g., SGI*, 183 F.3d at 986-87 (“Actual stock shares plus exercisable stock
 30 options represent the owner’s trading potential more accurately[.]”)

1 plaintiffs' allegations fail to reflect that Mr. Wu also *purchased 30,000 shares* during the Class
 2 Period. Walters Decl., Ex. G. With respect to Mr. Tu, the Forms 4 for the cited transactions
 3 reveal that the shares sold were not his personal holdings, but rather, the holdings of President
 4 (BVI) International Investment Holdings Ltd., for which he worked. *Id.* Ex. E.²³

5 **Timing of the Sales and Trading Patterns.** All but one of the challenged stock sales
 6 were in the IPO, a fact that is far from unusual or suspicious, since that was the first day on
 7 which there was a public market for the shares. *See, e.g., Ronconi*, 253 F.3d at 436 (“*Silicon*
 8 *Graphics* suggests that restrictions on an insider’s ability to trade are important in determining
 9 whether the trading pattern is suspicious.”). Moreover, plaintiffs’ contention that the individual
 10 defendants “sold millions of shares of Accuray stock at artificially inflated prices of more than
 11 \$28.00 per share” is simply erroneous. ¶ 10. All of the IPO sales were at the offering price of
 12 \$18,²⁴ and the lone non-IPO sale was at \$15.91. *Id.* In fact, although Accuray stock traded “as
 13 high as \$29.25 per share” (¶ 134), all of the sales were at or below the \$18 IPO price. “When
 14 insiders miss the boat this dramatically, their sales do not support an inference that they are
 15 preying on ribbon clerks who do not know what the insiders know.” *Ronconi*, 253 F.3d at 435.

16 Nor is the timing of the lone non-IPO stock sale suspicious. Dr. Adler’s November 12,
 17 2007 sale was made following the November 7, 2007 announcement of financial results (¶¶ 10,
 18 93). *See Lipton v. PathoGenesis Corp.*, 284 F.3d 1027, 1036-37 (9th Cir. 2002) (timing not
 19 suspicious where insider sold stock following positive announcement of results); *Yahoo! II*, 630
 20 F. Supp. 2d at 1118 (selling stock “following earnings releases” is “common practice among
 21 corporate executives”). Moreover, as with the other challenged sales, plaintiffs fail to provide
 22 any information regarding Dr. Adler’s holdings, the percentage sold, or any other contextual
 23 information. Absent such facts, the stock sales cannot support an inference of scienter. *Ronconi*,

24
 25 ²³ The allegations regarding the number of shares sold also are inaccurate. ¶ 10. As is shown
 26 in the Forms 4, the 3,953,191 number reflects a *correction* of the 4,084,450 number. *See* Ex E.

27 ²⁴ The price reflected in the chart (¶ 10) for the February 13, 2007 transaction attributed to
 28 Mr. Tu is inaccurate. This transaction was made in connection with the exercise of the IPO
 overallotment option and was made at the offering price of \$18. Walters Decl., Ex. E.

1 253 F.3d at 436-37 (plaintiffs “must allege sufficient context of insider trading”).

2 **2. The Compensation Allegations Add Little to the Analysis.**

3 Plaintiffs allege that “Defendants were incentivized to enter into term agreements and
 4 grow backlog,” and that Messrs. Thomson and Hampton, in particular, were motivated to include
 5 “bogus deals” in backlog because of the executive bonus structure. ¶ 89. Plaintiffs allege that
 6 Accuray changed its bonus structure for FY08 to make backlog “the single largest financial
 7 metric for determining the bonuses of certain senior executives,” including Messrs. Thomson and
 8 Hampton. *Id.* As plaintiffs’ allegations, however, make clear, backlog accounted for just 20% of
 9 Dr. Thomson’s bonus and a mere **6.5%** of Mr. Hampton’s bonus. *Id.* Although plaintiffs also
 10 allege that “85% of [Mr. Hampton’s] bonus” was to be “based *primarily* on achievement of
 11 quarterly sales quotas,” plaintiffs fail to plead any details regarding the quarterly sales quotas.
 12 Moreover, the SEC Form 10-K upon which plaintiffs rely clearly states that:

13 In establishing the bonus metrics and target bonus percentages for fiscal 2008, the
 14 [Compensation] Committee considered the Radford [executive compensation
 15 survey] select data as well as advice from [compensation consulting firm] Watson
 Wyatt regarding appropriate metrics that were both consistent with industry
 practice and would serve to align the interests of management with those of
 stockholders.

16
 17 Pl. Ex. 17 at 116. Plaintiffs fail to plead any facts suggesting that the compensation structure
 18 was somehow unusual or inconsistent with industry practice. *See, e.g., Rackable*, 2010 WL
 19 199703, at *9 (“Compared to the industry norms, there is nothing remarkable about the type or
 20 amount of compensation paid to Defendants.”).

21 **3. The Company’s Share Repurchase Negates Scienter.**

22 Plaintiffs allege that Defendants engaged in a scheme to inflate the price of Accuray stock.
 23 ¶ 49. What plaintiffs fail to acknowledge, however, is that Accuray also entered into a stock
 24 repurchase program during the Class Period and thus was *purchasing* its own shares in the open
 25 market. Pl. Ex. 25 at 16. It makes no sense for Accuray to purchase its own stock if, in fact,
 26 Defendants were knew the stock was inflated at the time. The stock repurchase program thus
 27 negates an inference of scienter. *See, e.g., In re Tibco Software, Inc. Sec. Litig.*, 2006 WL
 28 1469654, at *21 (N.D. Cal. May 25, 2006) (“Plaintiffs fail to respond to the authorities Defendants

1 cited . . . showing that stock repurchase programs actually *negate* a finding of scienter.”).

2 **C. Plaintiffs’ Reliance on the “Core Operations Inference” Is Unavailing**

3 Apparently recognizing that the Complaint fails to raise a strong inference of scienter as to
 4 any of the Defendants, plaintiffs attempt to invoke a “core operations” inference.²⁵ *See, e.g.*,
 5 Complaint at 11 & ¶ 30. The core operations inference, however, does not alter the stringent
 6 requirements of the Reform Act, nor does it change the standards articulated in *Tellabs*. The
 7 Complaint remains deficient under both. Regardless, the core operations inference, which applies
 8 only in rare circumstances, has no application here. As the Ninth Circuit has acknowledged,
 9 where, as here, the “complaint relies on allegations that management had an important role in the
 10 company but does not contain additional detailed allegations about the defendants’ *actual*
 11 *exposure* to [the disputed] information, it will usually fall short of the PSLRA standard.” *South*
 12 *Ferry*, 542 F.3d at 784 (emphasis added); *McCasland*, 2009 WL 2086168, at *6 (“[T]he complaint
 13 still does not (1) identify any specific information that was either received or communicated by
 14 any defendant, that (2) contradicts any public statement at the time it was made.”).

15 **D. Plaintiffs Cannot Counter the Strong, Competing Inference Raised by the
 16 Repeated Voluntary Disclosures of Negative Information**

17 Under *Tellabs*, an “inference of scienter must be more than merely ‘reasonable’ or
 18 ‘permissible’ – it must be cogent and compelling, thus strong in light of other explanations.” 551
 19 U.S. at 324. Although plaintiffs portray Defendants as concealing adverse information, plaintiffs’
 20 own allegations support the competing inference that Defendants promptly disclosed adverse
 21 information as it became known. Accuray repeatedly disclosed the negative changes affecting its
 22 business throughout the Class Period. *See, e.g.*, ¶¶ 105-06, 113-16. Those factors, which included
 23 the tightening credit markets and regulatory matters, were outside of the Defendants’ control. The
 24 situation was thus far “more consistent with a company and executives confronting a deterioration
 25 in the business and finding itself unable to prevent it than [it is] with a company and executives
 26 recklessly deceiving the investing community.” *Cf. In re 2007 Novastar Fin., Inc., Sec. Litig.*,

27
 28 ²⁵ *See generally South Ferry LP, No. 2 v. Killinger*, 542 F.3d 776 (9th Cir. 2008).

1 2008 WL 2354367, at *4 (W.D. Mo. June 4, 2008), *aff'd*, 579 F.3d 878 (8th Cir. 2009).

2 **E. Plaintiffs Have Not Pleaded Corporate Scienter**

3 Because plaintiffs fail to plead scienter as to any individual defendant, they cannot
 4 impute scienter to Accuray. *See, e.g., Pittelman v. Impac Mortgage Holdings, Inc.*, 2009 WL
 5 648983, at *3 (C.D. Cal. Mar. 9, 2009) (“Because Plaintiff fails to plead scienter on the part of
 6 [the CEO or COO], Plaintiff cannot successfully plead scienter on the part of Impac.”); *Davis v.*
 7 *SPSS, Inc.*, 385 F. Supp. 2d 697, 717-18 (N.D. Ill. 2005) (dismissing §10(b) claim against
 8 company where plaintiff failed to plead scienter against CEO or CFO). Although the Ninth
 9 Circuit has not foreclosed the possibility of “collective scienter,” those circumstances are not
 10 present here. *See Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736, 744-45 (9th Cir. 2008).

11 **F. The Claims Against the Outside Directors Should Be Dismissed**

12 Plaintiffs do not properly attribute any statement to four Defendants: Messrs. Tu, Wu,
 13 Adler, and Weiss. Indeed, other than certain stock sales (discussed in Section IV, *supra*), the
 14 only purportedly wrongful act attributed to any of these non-employee directors is that they
 15 signed the Registration Statement. ¶¶ 42(c)-(f), 51. Merely alleging that an individual signed a
 16 registration statement is insufficient to impose Section 10(b) liability. Plaintiffs do not allege
 17 any facts showing that these individuals were involved in the preparation or drafting of the
 18 Registration Statement, much less that they knowingly made a false statement. *Cf. Yahoo! I*, 592
 19 F. Supp. 2d at 1205 (“Without any supporting allegations that Defendants made false accounting
 20 entries or inflated revenues, Defendants’ signatures on the SEC certificates do not create a strong
 21 inference of scienter.”). Because plaintiffs do not allege that the outside directors made any
 22 statements other than the Registration Statement and have failed to plead a claim as to that
 23 document, the Section 10(b) claim against these Defendants should be dismissed.²⁶

24
 25 ²⁶ The discredited group pleading doctrine does not save the claims against these individuals.
 26 *See, e.g., Downey* 2009 WL 2767670, at *4 n.1 (“group pleading doctrine did not survive the
 27 PSLRA”); *Tibco*, 2006 WL 1469654, at *27 (“[C]ourts in this district are increasingly finding
 28 that the group pleading doctrine is contrary to the PSLRA.”). Indeed, even before the Reform
 Act, an outside director could not be held liable for a public filing simply because he signed it.
See, e.g., Stack v. Lobo, 903 F. Supp. 1361, 1376 (N.D. Cal. 1995) (“[A]n outside director does
 not become liable for the contents of a group published document merely by signing it.”).

1 **V. PLAINTIFFS’ “RULE 10(B)”/“RULE 10(B)(5)(1)” CLAIM IS UNINTELLIGIBLE**

2 Plaintiffs include a separate cause of action for “Insider Trading Violations of Rule 10(b)
 3 and SEC Rule 10(b)(5)(1)” against all “Defendants.” Complaint at 82. Although it is unclear
 4 from the two sentences provided in support of this cause of action (¶ 161), plaintiffs appear to be
 5 asserting an insider trading claim under Section 10(b) and SEC Rule 10b5-1. To pursue an
 6 insider trading claim, however, among other requirements, plaintiffs must have traded
 7 “contemporaneously” with the defendant. *Neubronner v. Milken*, 6 F.3d 666, 670 & n.5 (9th Cir.
 8 1993). Because plaintiffs do not allege that they traded contemporaneously with any defendant,
 9 and because plaintiffs have not stated a Section 10(b)/Rule 10b-5 claim, this claim also fails.

10 **VI. PLAINTIFFS’ SECTION 20(a) CLAIM SHOULD BE DISMISSED**

11 Because the Complaint does not adequately allege an underlying primary violation, the
 12 Section 20(a) control person claim should also be dismissed. *See Lipton*, 284 F.3d at 1035 n.15.
 13 In addition, plaintiffs must plead “that the defendant exercised actual power or control over the
 14 primary violator[.]” *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). To
 15 establish control, a plaintiff must allege specific facts showing that the defendant participated “in
 16 the day-to-day affairs of the corporation and [possessed the] power to control corporate actions.”
 17 *Id.* (citation omitted). The complaint fails to plead any such facts with respect to the outside
 18 director defendants and Mr. Hampton. *See Arthur Children’s Trust v. Keim*, 994 F.2d 1390,
 19 1396-97 (9th Cir. 1993) (“A director is not automatically liable as a controlling person.”).

20 **CONCLUSION**

21 For the foregoing reasons, Defendants respectfully request that the Court dismiss the
 22 Complaint.

23 Dated: February 8, 2010

24 **WILSON SONSINI GOODRICH & ROSATI**
 25 Professional Corporation

26 By: /s/Ignacio E. Salceda
 27 Ignacio E. Salceda

28 Attorneys for Defendants